International Economic Policy | 1. The main issues

1. Defining the subject

The aim is to study how governments (or, in general, public authorities, like central banks) make decisions that simultaneously affect their domestic economies and also foreign economies (and, consequently, foreign governments). These decisions will be called 'international decisions'. The terms 'government', 'state', 'country' are used equivalently.

2. Basic approaches

• The conventional, orthodox approach emphasizes the economic dimension of the decision (the focus is on 'economic' in 'economic policy'). The discipline emerging from this approach is 'International economics'.

• The heterodox approach emphasizes the political dimension (the focus is put on 'policy'). The associated discipline is 'International political economy'.

• This course favours the heterodox approach: in the international domain, the political aspect (geopolitics) frames economic policy decisions. Governments are created as political actors and that political component determines how governments interact among themselves, no matter the extent of the economic nature of the interaction. Evidence for this claim is the fact that governments can always choose to make war to (use brute force over) another government. That possibility is not allowed to private actors (individuals, households, small businesses, big corporations, commercial banks…).

3. Three types of international decisions

• Non-strategic decisions. In this case, the government's decision is analyzed in isolation, without taking into account possible reactions by other governments. For instance, the decision to increase or lower the economy's degree of commercial or financial openness or the decision regarding the flexibility of the exchange rate are often studied by taking as given the international context. Most of the analysis presented in international economics textbooks deals with non-strategic decisions.

• Strategic decisions. In this case, governments face a game situation: in choosing their decisions, they must take into account other governments' decisions. For example, since it is natural to expect some form of retaliation when a government raises tariffs (or sets economic sanctions on other countries), it seems necessary to make the decision anticipating the reaction by the governments affected. The interaction need not be non-cooperative: the signing of commercial treaties involve negotiations and, therefore, cooperative strategic decisions (what concessions give in return to favourable conditions granted by other governments).

• Decisions creating, and conditioned by, supranational actors. Occasionally, the cooperation among governments is expressed in the creation of rules restricting the governments' freedom to make decisions (for instance, the fiscal rules on deficit and debt-over-GDP that eurozone members have agreed to meet). Sometimes, this cooperation takes the form of a new agent: an international institution. The World Bank, the International Monetary Fund or the European Central Bank are examples.

In the non-strategic decision case, the main actor is a government, that makes decisions affecting (in a top-down fashion) both the domestic and the foreign economies. In the strategic decision case, there is a multiplicity of main actors (the governments), whose decisions affect 'horizontally' (the governments) and 'vertically' (the economies). When a supranational actors is involved, a new interaction level is created: governments need not only take into account how their decisions affect (downward) economies and (horizontally) other governments, but also (upward) international bodies.

This course focuses on the second kind of decisions, since international bodies currently are, in general, too weak to limit what international decisions governments can make (and, as Brexit illustrates, states largely retain the power to free themselves from the obligations imposed by supranational institutions: all sovereignty transferred to such institutions can be retrieved at will).

4. Issue 1a: the political world order is hierarchic, but necessarily so?

Viewed as a market, the interaction between states is not competitive: some states (the core of the world order: those whose economies are the most advanced) are much more powerful (in economic, military, technological, territorial, demographic sense) than others (the semiperiphery and the periphery). The hand regulating that interaction is quite visible: the hegemon (currently, the US). That is why the world order is hierachic and hegemonic: at the top, there is the most powerful state (dictating global rules, imposing constraints on other governments, having a strong influence on international public organizations), next there is a group of sufficiently powerful states (some of them, like China now, aspiring to reach the hegemonic status or, at least, increasing it power vis a vis the hegemon), below some middle powers (like Spain), below that class the successful peripheric states (those aspiring to become at least a middle power) and, at the bottom, the unsuccessful peripheric states (which, in practice, must please higher powers and, through all forms of exploitation, are condemned to remain peripheric). There is another category below the bottom: the failed states, whose governments are too weak (due to war or famine, typically) to even control their own territory.

• Since the end of the Second World War, the US has been the dominant capitalist country in the international system. The US has been the global hegemon. As such, it has promoted freer trade, defended liberalism and played a central role in most international institutions.

• This idea is important because economic policy considerations cannot abstract from the asymmetry of the world order: governments above in the hierarchy can dictate governments below what to do (with the implicit threat of being subject to sanctions if those governments do not comply; see Cuba, Venezuela, North Korea, Iran…). That asymmetry also tends to be present regionally. In the European Union, for instance, Germany appears to be the (rather reluntant) hegemon (apparently, Germany leads by establishing rules, rather than by dictating actions). In East Asia, China plays the geopolitical leading role (the Road and Belt Initiative could be viewed as a first step towards China's hegemonic dominance in Eurasia).

5. A paradox of dominance?

If the global contest for dominance is a zero-sum game, then the resources used by the rising powers are no longer available to the lead states to maintain or expand their dominance. In fact, the economic system created by the dominant powers is used by the challengers to rise: when the profit opportunities become scarce in the lead economies, it becomes an attractive option to invest abroad and that helps less developed economies to expand and close the gap with the richer economies. As it is cheaper to produce in poorer economies, these economies could develop easier and faster by selling their production in the leading economies. Hence, the initial leadership of some economies is accompanied by convergence of the rest of economies.

> "The paradox of power for the USA is therefore that the very economic system that has propelled it on to the world stage also contains within it the potential seeds of its own destruction." Glenn (2016, p. 2)

Glenn, John G. (2016): *China's challenge to US supremacy: Economic superpower versus rising star*, Palgrave Macmillan, London.

6. The decline of the US vs the rise of the rest

> "There have been three tectonic power shifts over the last five hundred years, fundamental changes in the distribution of power that have reshaped international life—its politics, economics, and culture. The first was the rise of the Western world, a process that began in the fifteenth century and accelerated dramatically in the late eighteenth century. It produced modernity as we know it: science and technology, commerce and capitalism, the agricultural and industrial revolutions. It also produced the prolonged political dominance of the nations of the West. The second shift, which took place in the closing years of the nineteenth century, was the rise of the United States. Soon after it industrialized, the United States became the most powerful nation since imperial Rome, and the only one that was stronger than any likely combination of other nations. For most of the last century, the United States has dominated global economics, politics, science, and culture. For the last twenty years, that dominance has been unrivaled, a phenomenon unprecedented in modern history. We are now living through the third great power shift of the modern era. It could be called 'the rise of the rest'." (Zakaria, 2011)

Zakaria, Fareed (2011): *The post-American world: Release 2.0*, W. W. Norton, New York.

7. The rise and fall of great powers appears to be a stylized fact of international relations

The rise and fall of great powers is a process in which the the emergence of a new power challenges the status quo represented by the dominance of some global power. Basic explanations for the fall are: (i) internal instability; (ii) external over-extension. The basic explanation for the rise is emulation: the states lagging behind the leading powers learn from them how to catch up. In the process of developing and accumulating power, the lead states that first go through this process may attempt several strategies of which some may prove unsuccessful. The less developed or weaker states do not have to replicate failures, since they may just adopt the successful strategies. The laggards do not need to go through all the stages that the leaders initially followed and that allows the laggards to catch up faster and at smaller cost than the vanguard states.

An interesting question is why not all laggards prosper to rival the most powerful states. One simple explanation is that leading powers preserve their status by preventing less developed states to catch up (essentially, by exploiting the resources of those poorer states). Even though some state may successfully escape exploitation by higher powers and the limits imposed to their development, most of them remain trapped in underdevelopment. That strategy by the leading powers (block others' development) preserves the asymmetry of the world order. When an emerging power replaces the hegemon it does not make the system more balanced, equal and symmetric: it simply takes the place of the former hegemon to reproduce the same blocking strategy. E. H. Carr has identified the 'problem of peaceful change' as the central dilemma of international relations.

"There is but one rule: hunt or be hunted." House of cards, Season 2, Episode 1

8. Global power structures

Unipolarity (William Wohlforth) is a structure in which one state's capabilities are too great to be counterbalanced. Bipolarity: two states are substantially more powerful than all others, with capabilities not so concentrated to create a global empire. Multipolarity is a structure comprising three or more significantly powerful states.

> "The coming world will be both multipolar and politically diverse; it will consist of major powers that embrace distinct conceptions of what constitutes a legitimate and just order." Kupchan (2012, p. x)

Kupchan, Charles A. (2012): ***No one's world: The West, the Rising Rest, and the coming global turn*, Oxford University Press, New York.**

9. US vs China, West vs East

> "Three main paths from these scenarios would then open up: one leading to conflict—most likely through regional disputes rather than full confrontation (given that both are nuclear weapon states); another leading to the development of two separate and antagonistic systems; and a final path that promises a peaceful transition to a Chinese-led world order." Glenn (2016, p. 219)

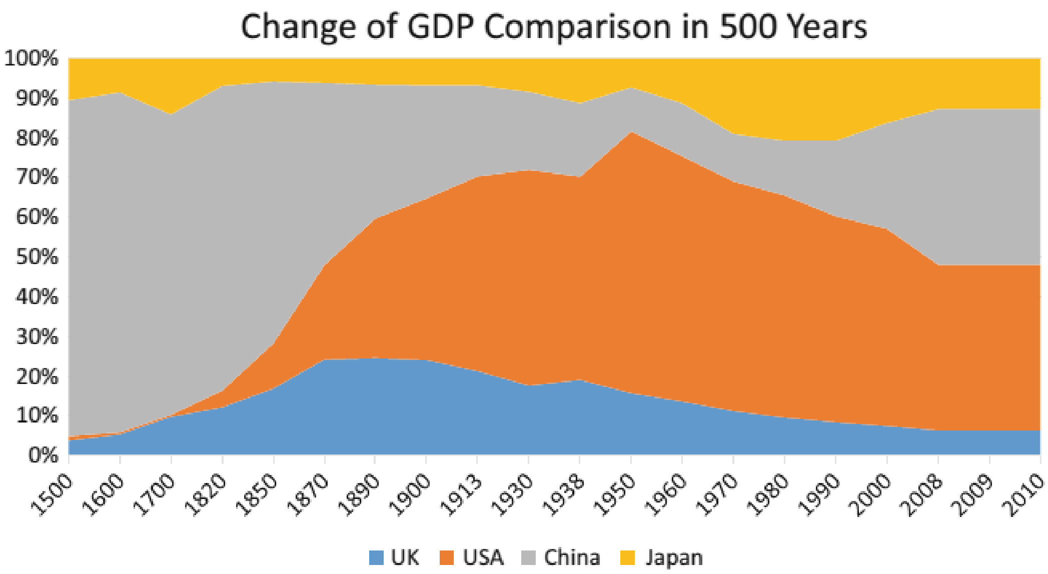
> "The preservation of the Western order requires that the advance of modernization in the developing world produces a homogenous community of nations along Western lines. The problem is that the defining attributes of the West—liberal democracy, industrial capitalism, and secular nationalism—are not being replicated as developing regions modernize. To be sure, capitalism has demonstrated its universal draw. But most rising powers—China, India, Turkey, and Brazil among them—are not tracking the developmental path followed by the West. They have different cultural and socioeconomic

foundations, which give rise to their own domestic orders and ideological orientations. Accordingly, emerging powers will want to revise, not consolidate, the international order erected during the West's watch." Kupchan (2012, p. 7)

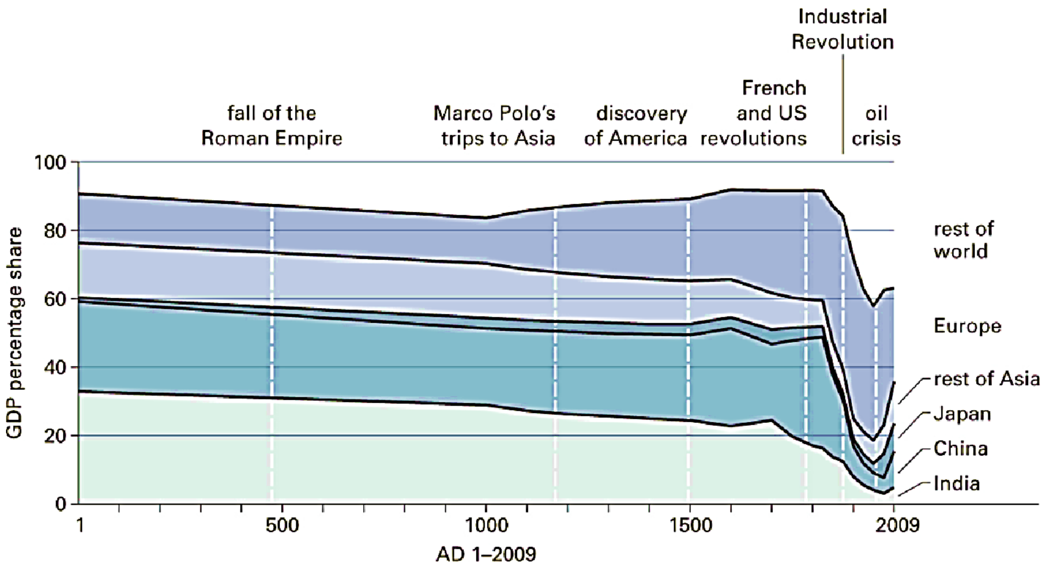
10. Is the future multipolar?

"At its peak, U.S. dominance spread to effectively all areas, shaping the global power balance. It was the largest production power, trade power, technological power, financial power, and military power, as well as, of course, the most influential player in global politics. In the new brave world of the early twenty-first century a single nation—be it America, China, or anyone else—is no longer capable of being a champion in all these areas across the board. The world is becoming more and more multipolar and, consequently, increasingly difficult to lead." Tselichtchev (2012, p. 207)

Slantchev, Branislav L. (2017): "On the proper use of game-theoretic models in conflict studies", *Peace Economics, Peace Science and Public Policy*, 20170041, 1-14.



Kai, Jin (2017): *Rising China in a changing world: Power transitions and global leadership*, Palgrave Macmillan, Singapore.



Mahbubani, Kishore (2008): *The new Asian hemisphere: The irresistible shift of global power to the East*, PublicAffairs, New York.

11. China's vertical world map

"China has emerged as a member of the elite club of nations that are powerful at both global poles. Polar states are global giants, strong in military, scientific, and economic terms (…) China's focus on becoming a polar great power represents a fundamental reorientation – a completely new way of looking at the world. Nothing symbolizes this shift more than China's vertical world map (…). This map, devised by Hao Xiaoguang, a brilliant geophysicist from Wuhan, has been used since 2004 by China's State Oceanic Administration to chart voyages to the Arctic and Antarctic and, since 2006, by the People's Liberation Army (PLA) as an official military map (…) The map is the visual representation of China's new global Realpolitik: pragmatic, assertive of China's national interests, cooperative where it is possible to be cooperative, and yet ready to face up to conflict."

Brady, Anne-Marie (2017): *China as a Polar Great Power*, Cambridge University Press, Cambridge, UK.

12. Issue 1b: balance of power vs hegemony

"Recent work demonstrates that the European state system—which, since the Middle Ages, saw the recurrent formation of balances of power—constitutes a historical exception rather than the rule among anarchic international systems. In this study, I set out to explain why Europe avoided hegemony. I argue that the character of state–society relations at the time of intensified geopolitical competition leads to different systemwide outcomes with respect to balancing and hegemony. Where multiple privileged groups already exist, rulers must negotiate with a range of societal actors to extract revenue and resources for warfare. This further entrenches institutional constraints on rulers and the privileges enjoyed by societal groups, which in turn make it difficult for rulers to convert conquest into further expansion. In the absence of preexisting multiple privileged groups, however, geopolitical competition instead further weakens the ability of societal actors to check their rulers. This dynamic creates a return-to-scale logic that facilitates systemwide conquest. My argument accounts for the diverging trajectories of, on the one hand, medieval and early modern Europe and, on the other hand, ancient China—where the state of Qin eliminated its rivals and established universal domination."

Møller, Jørgen (2014): "Why Europe avoided hegemony: A historical perspective on the balance of power", International Studies Quarterly 58(4), 660-670.

13. Scenarios for Asia's future

- Anarchy: "Asia's future could be Europe's past, specifically German expansion and great power competition leading to world wars. Asia is 'ripe for rivalry' because it lacks Europe's conflict-mitigating forces of economic interdependence, multilateral institutions and shared democracy."
- Hegemony: "China would impose a 'Monroe doctrine' over Asia, excluding the United States".
- Hierarchy: "A benign Chinese dominance as prevailed under its tributary system. When China was prosperous and powerful, Asia was stable and peaceful."
- Concert/condominium: "A managed balance of power system, either a multilateral concert of major powers, or a Sino-US duopoly (condominium); one such scenario posits China and the United States dominating the Asian heartland and maritime spheres, respectively."
- Community: "East Asia moving from a region of nations to a bona fide regional community where collective efforts are made for peace, prosperity and progress."

Acharya, Amitav (2014): "Power shift or paradigm shift? China's rise and Asia's emerging security order", International Studies Quarterly 58(1), 158-173.

14. Issue 2a: does international trade prevent international conflict?

Realism and liberalism are two of the competing paradigms in international relations. The main theoretical claim by realism is that states constantly struggle for power or security; the one by liberalism is that states are more concerned about certain economic and political goals (economic prosperity, commitment to certain values) than about power in itself.

The liberal paradigm contends that mutual gains from trade lowers the chance that states resort to conflict: trade creates international harmony.

> "Liberal theories generally assume that political leaders are deterred from engain conflict when they anticipate that conflict will disrupt or eliminate trade or adversely affect the terms of trade, so the hypothesis that trade deters war rests on the assumption that war impedes trade. Realist theories suggest that the concern over relative gains will lead at least one of the belligerents to terminate trade in order to prevent its adversary from using the gains from trade to increase its relative military power."

Barbieri, Katherine; Jack S. Levy (1999): "Sleeping with the enemy: The impact of war on trade", Journal of Peace Research 36(4), 463-479.

Barbieri, Katherine (2002): *The liberal illusion: Does trade promote peace?*, University of Michigan Press.

15. Issue 2b: does domestic democracy prevent international conflict?

- **Democratic peace correlation: why do democracies not fight each other?**

"Perhaps the simplest explanation for where fault lines lie in a political process involves the presence of an 'other.' Difference divides and similarity unites. These similarities and differences can in turn orient and propagate conflict. Yet, similarity and difference are also dynamic, evolving in response to changing population characteristics or a new reference point. We offer a simple explanation for interstate conflict in which the salience of similarity or difference varies with the prevalence or capabilities of groups. We apply our argument in the context of the democratic peace. When democracies are scarce or weak, and autocracies plentiful and powerful, democracies face a common threat. As the democratic community strengthens, however, the threat from autocracies declines and differences among democracies appear more salient. Our findings contrast with standard expectations about how democratization shapes world affairs."

Gartzke, Erik; Weisiger, Alex (2013): "Permanent friends? Dynamic difference and the democratic peace", International Studies Quarterly 57(1), 171-185.

- **Democratic vs economic peace: contract flows within nations may cause both democracy within nations and peace among them**

"Recent studies show that the democratic peace correlation is not significant once the potentially confounding variable that can cause both democracy and peace, contract-intensive economy, is considered; this pattern holds in analyses of wars, fatal militarized interstate conflicts, and interstate crises. These studies rescind the primary evidence for democracy being a cause of the democratic peace and indicate that contract-intensive economy is the more likely explanation for it. This article addresses all recent defenses of the democratic peace correlation, reports results using a new measure of contract flows, and extends the investigation to all militarized interstate conflicts. Analyses of most nations from 1961 to 2001 show that there is no correlation of democracy with peace, and contract-intensive economy is one of the most powerful nontrivial variables in international conflict. The era of the democratic peace appears to be at an end, subsumed by an economic peace."

Mousseau, Michael (2013): "The democratic peace unraveled: It's the economy", International Studies Quarterly 57(1), 186-197

16. Issue 3a: which forces are stronger, those of integration or those of fragmentation?

Governments obtain benefits from some degree of integration (access to foreign resources and commodities, political coordination to address common problems). The problem is that, with time, unintended, unforeseeable or undesirable consequences of integration arise. Once this is the case, the natural options are two: (i) to integrate further as a means to address the consequences (in teh eurozone case, countries give up their own currencies and adopt a common one to avoid exchange rate risks, volatility or crises and thereby lower transaction costs); and (ii) to de-integrate, meaning to reject the compromises associated with the degree of integration previously chosen (Brexit is a recent illustration, as well as the tariff rise to Chinese and EU goods by the Trump administration). The question is whether one of the forces (integration and fragmentation) dominates in the long run and, if so, which one. Specifically, will the planet become fully globalized, with a single global government?

17. The European Union / eurozone experiment

The ongoing process of European economic and political integration constitute a test for the likelihood of a successful global integration. If countries with a common history and similar economic, political and cultural systems fail to fully integrate, it is implausible to expect full integration at the world scale.

"European monetary union lacked an adequately formalized, balanced, and supportive structure of creditor-debtor state relations. Both governance structures and crisis prevention and crisis management policy instruments were inadequate for this purpose. The euro area possessed neither the governance structures nor the policies that credibly embodied criteria of impartiality, fairness, and effectiveness in managing the costs of adjustment. It required a combination of euro area fiscal transfer arrangements; encouragement of sustained public investment; tough fiscal discipline; country-specific contractual arrangements for structural reforms in both creditor and debtor states; and independent supra-national institutions with the discretionary authority to act in a speedy, decisive, and bold manner in banking and sovereign debt crises, with generous credit lines at their disposal."

"Monetary union could not survive in the context of a regulatory union. It required the EU to become a macroeconomic union. Flanking fiscal rules were not enough. European macroeconomic union needed to be founded on a new, inclusive model of economic growth. This model would focus on shifting priority to productivity-enhancing infrastructure and social investment. It would combine implementation of structural and fiscal reforms, for instance to labour markets, with active measures to compensate losers through fiscal transfers and to prioritize investments. In the absence of this type of growth model, the euro area faced a serious and potentially widening legitimacy gap with dangerous social, economic, and political consequences."

"The post-2007 crisis also showed the naïvety in believing that Member States could be relied on to comply with fiscal rules or that the Council could be expected to act against fiscal 'sinners'. Domestic elites and publics were not always prepared to tolerate the sacrifices required."

"We all know what to do, we just don't know how to get re-elected after we've done it."

Attributed to Jean-Claude Juncker, quoted in Dyson (2014)

Dyson, Kenneth (2014): *States, debt, and power. European history and integration,*

"The overriding theme of this book is that, before and during the crisis, the Eurosystem experienced soft budget constraints. Before the outbreak of the crisis, too much private capital flowed from North to South, creating the inflationary bubble that deprived the South of its competitiveness. The excessive capital flows resulted primarily from the implicit protection that the common currency represented for investors, who could not imagine any risk of bank or state insolvencies in countries that had access to the liquidity of the Eurosystem, being able to print the money needed to redeem the debt if necessary. It also resulted from the encouragement that investors received from the EU's banking and insurance regulation system. This system contradicted the no-bail-out clause of the

Maastricht Treaty which, had it been taken seriously, should have given investors pause and reduced the capital flows."

[The no-bailout clause (Treaty on the Functioning of the EU, art. 125) holds that no Eurozone member state shall assume the commitments of another member state.]

"After the outbreak of the crisis, public capital was made available via the ECB to compensate for the dearth of private flows (…) However, rather than attempting to return to the tight public budget constraints demanded by a market economy, the ECB and the community of euro states continued their policy of soft budget constraints by providing a growing amount of public credit at below-market interest rates, bailing out both the debtors and their creditors in the process. This destroyed one of the basic pillars of the Maastricht Treaty."

"The Hungarian economist János Kornai predicted in 1980 that soft budget constraints would lead to the demise of the communist economic system. The Eurozone currently runs the risk of sharing this fate. While soft budget constraints help in the short run and reduce the probability of a collapse of the system, they remove the incentives to tackle the structural reforms that would cure the disease."

"It is also doubtful whether Europeans will continue to live in harmony if the public bail-out policy persists, for such a policy raises creditor–debtor relationships from the private to the public sphere, where there is no civil law to settle the disputes, and fuels heated public debates that stir up animosity and strife. History is full of examples of the problematic relationship between creditors and debtors."

Sinn, Hans-Werner (2014): ***The euro trap: On bursting bubbles, budgets, and beliefs*****, Oxford University Press, Oxford, UK.**

18. Issue 3b: are there decreasing returns to integration?

Integration processes do not integrate along all, or most, dimensions: economic integration need not involve political integration; even if both take place simultaneously, it is rare to achieve cultural or social or linguistic integration. Moreover, even if several dimensions are integrated at the same time, the timing may substantially differ: political integration can be attained faster than economic integration, and this one faster than cultural/social integration.

As a consequence, integration along some dimension may have to stop to allow other dimensions to catch up in the integration process. That stop may be perceived as a sign that integration is a bad policy option or may facilitate the emergence of troubles whose solution requires a more advanced integration in the remaining dimensions. The EU/eurozone troubles after the 2008 financial crisis (and the tensions currently made evident in dealing in the COVID-19 pandemic) perhaps illustrate this possibility.

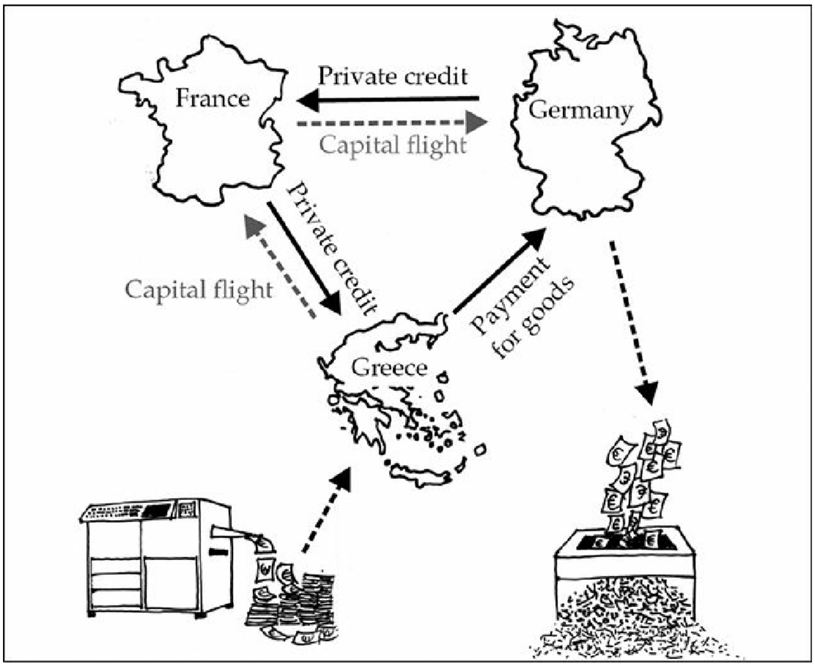
The fact that a successful, durable integration in one dimension may require a simultaneous integration along other dimensions may prevent full integration along any dimension. In this respect, integration episodes may be actually bubbles, which explode (fragmentation tendencies dominate) once it is realize that other integrations cannot continue.

The COVID-19 crisis may deglobalize the world economically and politically because national health systems have experienced integration to almost no degree. Consequently, a global problem has to be tackled nationally. This situation destroys precisely what is most required in integration process: mutual trust and support.

> "Lasting peace cannot simply be political. It has to be born out of trust and honesty and understanding and, most importantly, a will on both sides to move forward. Currently, that will does not exist. This peace is fraudulent." 24, Season 8, Episode 24

19. Imbalances of payments in the eurozone: the TARGET (Trans-European Automated Real-time Gross settlement Express Transfer system) system

"Target is the name of the settlement system through which international euro transactions between banks in the Eurozone are processed (…) The Target system channels and measures payment orders between the national central banks (NCBs) in the Eurozone that result from orders given by public and private financial institutions to their respective commercial banks. A Target deficit of an NCB is a net outflow of payment orders to other countries, or, in economics parlance, a balance-of-payments deficit. Conversely, a Target surplus is a net inflow of payment orders from other countries, or a balance-of-payments surplus (…) The Target system captures only the electronic movement of money, i.e. the international money transfers. only cross-border transactions are captured by the Target balances."

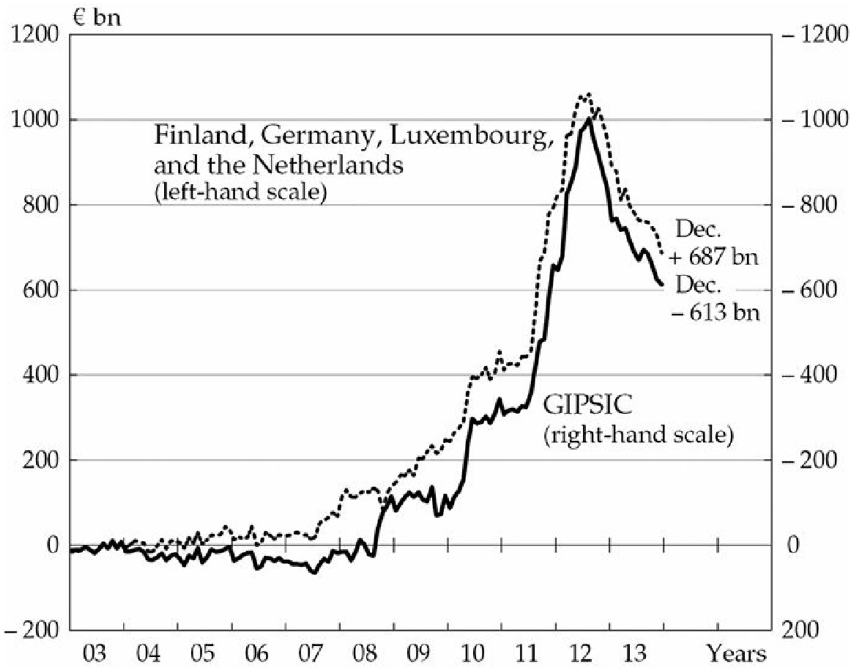


Payment flows in a balance-of-payments equilibrium and a balance-of-payments crisis

"Greece buys more goods from abroad than it exports. Therefore, it requires money to cover the shortfall. To get the funding, it taps the international capital markets. Money flows, for example, from a French bank through a Greek bank to one of its customers, who in turn transfers it to Germany because he wants to import a German car. The money comes from abroad and flows abroad once again. The Greek balance of payments is in equilibrium. This is the way it was before the financial crisis."

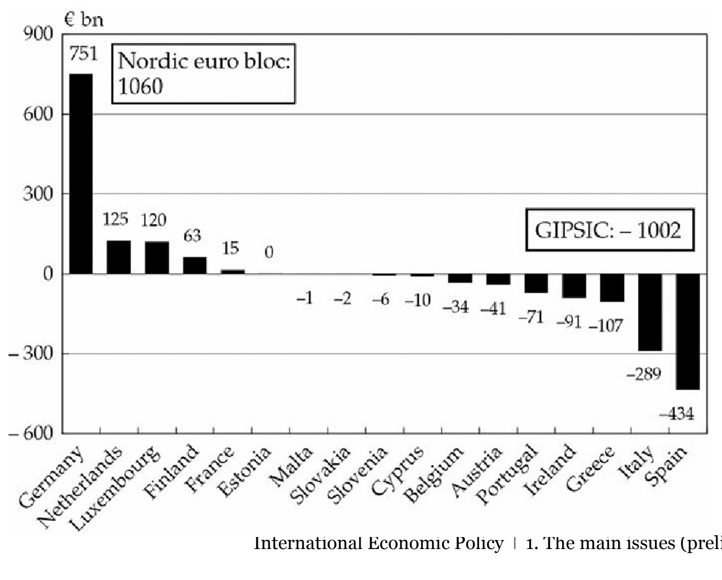
"In a country like Germany, which has an export surplus, it was the other way around. Germany enjoyed an inflow of money from abroad because it exported more than it imported; it used the funds to purchase bonds, shares of stock, property or other assets abroad, or to provide credit to foreign borrowers. Money flowed for instance from Germany via the Benelux countries to French banks, from where it was forwarded to Greece. In all countries, money flowed in both directions across borders, but there were no net flows of money across borders. The Target balances or the balance of payments were roughly zero, i.e. there was a balance-of-payments equilibrium."

"A balance-of-payments imbalance occurs when more money flows across borders in one direction than in the other, i.e. when outflows and inflows don't net out and a balance remains. If, for instance, the Greek car buyer does not get a loan from France, but wishes to purchase the car nonetheless by transferring money already existing in Greece, a Target deficit or balance-of-payments deficit will result, since now the same amount of money will have left Greece as before, but less money will have flowed into the country. If all other things remain equal, a surplus will arise in France, since less money has been transferred to Greece, while the German balance of payments remains in equilibrium. Of course, in this situation it is likely that the flow of credit from Germany to France ceases, since France no longer needs the credit. In this latter case, the balance-of-payments surplus in our example occurs in Germany, not France."



Cumulative balance-of-payments imbalances in the Eurozone (January 2003- December 2013)

"During the crisis, private capital flows not only dried up, for some countries and over certain periods, they even reversed their direction, since there was outright capital flight, primarily taking the form of lenders deciding not to roll over outstanding loans and demanding repayment (…) In the above example this is represented by the dashed arrows from Greece to France and from France to Germany. Greece now has to issue net payment orders to other countries not only for buying goods from there, but also for redeeming the existing debt. Balance-of-payments imbalances such as those between Eurozone countries can also occur in principle among regions within a country, or between the Eurozone and the rest of the world. However, the probability of such imbalances emerging on a large scale is very small."

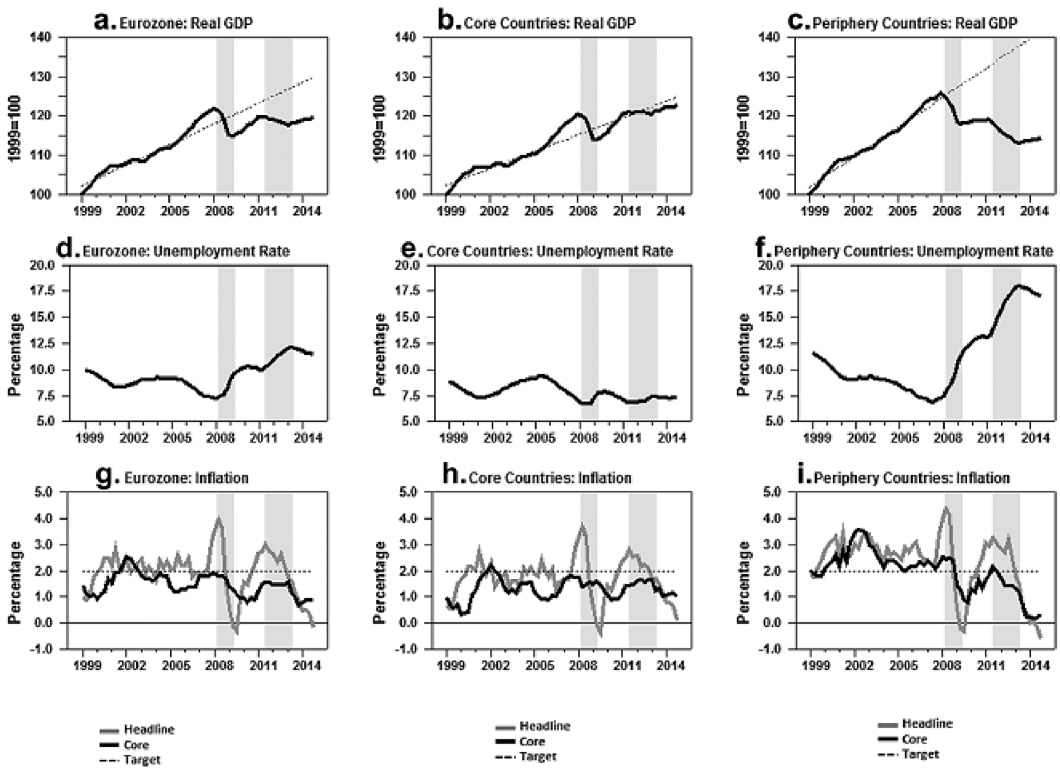


Target balances by country (peak values August 2012)

20. Eurozone crisis

"The eurozone crisis represents one of the greatest economic tragedies of the past century. It has caused immense human suffering, which continues to this day. The standard view attributes the economic crisis to an earlier buildup of public and private debt that was augmented by the imposition of austerity during the crisis. Although evidence exists of a relationship between the debt buildup, austerity measures, and economic growth during the crisis, that same evidence, on closer examination, points to eurozone countries' common monetary policy as the real culprit behind the area's sharp decline in economic activity. In particular, it seems that the European Central Bank's tightening of monetary policy in 2008 and again in 2010-2011 not only caused two recessions but also sparked the sovereign debt crisis and gave teeth to the austerity programs. Such findings point to the need for a new monetary policy regime in the eurozone. The case is made for the new regime to be a targeted growth path for total money spending."

Beckworth, David (2017): "The monetary policy origins of the eurozone crisis", International Finance 20, 114-134



Gray bars = GDP recession

core countries = Austria, Belgium, Finland, France, Germany, and the Netherlands;

periphery countries = Greece, Ireland, Italy, Portugal, and Spain

21. EU crisis: a constitutional culture trilemma

"There are three paths to constitutionalism in the modern world. Under the first, revolutionary outsiders use the constitution to commit their new regime to the principles proclaimed during their previous struggle. India, South Africa, Italy and France have followed this path. Under the second, establishment insiders use the constitution to make strategic concessions to disrupt revolutionary movements before they can gain power. Britain provides paradigmatic examples. Under the third, ordinary citizens remain passive while political and social elites construct a new constitution. Spain, Japan and Germany provide variations on this theme.

Different paths generate different legitimation problems, but the EU confronts a special difficulty. Since its members emerge out of three divergent pathways, they disagree about the nature of the union's constitutional problem, not merely its solution. Thus the EU confronts a cultural, not merely an economic, crisis."

Ackerman, Bruce (2015): "Three paths to constitutionalism – and the crisis of the European Union", British Journal of Political Science 45(4), 705-714.

22. The Schuman Declaration (9 May 1950)

"Europe will not be made all at once, or according to a single plan. It will be built through concrete achievements which first create a de facto solidarity. The coming together of the nations of Europe requires the elimination of the age-old opposition of France and Germany. Any action taken must in the first place concern these two countries. With this aim in view, the French Government proposes that action be taken immediately on one limited but decisive point. It proposes that Franco-German production of coal and steel as a whole be placed under a common High Authority, within the framework of an organization open to the participation of the other countries of Europe. The pooling of coal and steel production should immediately provide for the setting up of common foundations for economic development as a first step in the federation of Europe, and will change the destinies of those regions which have long been devoted to the manufacture of munitions of war, of which they have been the most constant victims. The solidarity in production thus established will make it plain that any war between France and Germany becomes not merely unthinkable, but materially impossible."

23. Dominant view in social science: 'expectation of ultimate positive convergence of all states' (debate homogenization/convergence vs heterogenization/polarization)

"Over the past two centuries, the dominant view in social science has been that the modern world shows a pattern of linear development in which all positive trends go upward in more or less linear fashion (albeit perhaps at an uncertain speed), and that therefore over time discrepancies between the leaders and the laggards are overcome, eventually resulting in a relatively homogenized world."

"…in the post-1950 period, a number of analysts began to contest this linear model (…) The linear progress model viewed the modern world as a process of homogenization and therefore one of overcoming the gaps between states or groups of any kind. Against this view, many social scientists began to argue that the modern world was one of heterogenization and polarization. Indeed, they said, the pattern of polarization escalated over time, the result of the way in which the modern world was structured (…) In analyzing the social world, the linear versus polarizing models of historical development became a debate about whether the various zones (or countries) of the world-system would converge to an approximately equal standard of living and similar political and cultural structures, or in fact over time would diverge ever more sharply."

Wallerstein, Immanuel Maurice; coord. (2015): *The world is out of joint: World-historical interpretations of continuing polarizations*, Routledge.

24. The international monetary system

The international monetary system is defined by the set of rules, practices and institutions that organize and regulate economic and financial transactions between different national jurisdictions. At the most basic level, this system establishes:

- exchange rate regimes (anything between fixed and floating exchange rate regimes) between national currencies;
- how to create and transfer international liquidity;
- policies to correct balance of payments disequilibria (or other kinds of external imbalances).

25. International monetary institutions

These are supranational institutions that have been conferred by national authorities some policy-making and supervisory (limited) as a way to consolidate and make more effective international cooperation.

- Bank for International Settlements (BIS, 1930). Its creation was the first instance of institutional monetary cooperation. It was created by the central banks of the winners of World War I to manage the flow of war reparations imposed on Germany. The BIS was essentially limited to act as a central banks' bank and to facilitate monetary cooperation informally. In the BIS, several committees have been established to coordinate central bank activity: the Basel Committee on Banking Supervision (BCBS), the Committee on Payment and Settlement Systems (CPSS) and the Committee on the Global Financial System (CGFS). In parallel, supervisory committees for stock exchanges and capital markets (International Organization of Securities Commissions or IOSCO) and for insurance companies (International Association of Insurance Supervisors or IAIS) have also been created.
- International Monetary Fund (IMF, 1946). It was the first truly international monetary authority, endowed with its own statute, powers and financial resources: with some 185 members, it is the only institution of truly global dimensions and scope. In practice, the IMF has exercised its authority rather on the basis of the consensus of its leading members than on the use of its attributed powers. The IMF has acted as a forum for the discussion of international monetary issues, has limited its power to influence economic policies to countries asking for financial aid to the Fund, has managed to exert some influence over financial markets and has become a leading observer of the world economy and evaluator of the economic policies conducted by leading countries. As for developing countries, the IMF serves the purpose of providing a sort of certificate of good conduct for countries that aim to operate in global markets. To halt financial crises and prevent contagion, the IMF can provide financial resources and financial assistance (by drawing on its own resources or helping to mobilize funds from official creditors and private financial institutions). Though the analyses emanating from the IMF may have some credibility or importance for market participants, IMF interventions have systematically being subject to criticisms and the IMF itself accused of making seriuous judgement errors.

- G20 (Group of Twenty, 1999. It includes the 19 states in the table below plus the European Union, represented by the European Commission and the ECB. Spain has been accepted as a permament guest). Created as the G20 Finance forum to share (with developing members) the best economic policy practices (from wealthy members), particularly in regard to international financial stability. The financial crisis of 2008 (which began in a wealthy member in 2007, the US) showed that policy learning had to cease to be one way, as the richer countries no longer could claim superiority in their policies. Since then the G20 has become the hub of international economic governance. Since 2008, the group hosts (i) a summit of heads of government or heads of state and (ii) meetings of finance ministers and central bank governors. The G20 approach to reform global finance has spanned four area: regulatory reform; improvement of the regulatory co-operation and the oversight of the global financial system; mechanisms to avoid taxpayer bailouts; and design of procedures for risk assessment and implementation of the new financial standards.

Luckhurst, Jonathan (2016): *G20 since the global crisis*, Palgrave Macmillan, New York.

Kathuria, Rajat; Neetika Kaushal Nagpal; eds. (2016): *Global economic cooperation: Views from G20 countries*, Springer, New Delhi.

Group 1	Group 2	Group 3	Group 4	Group 5
Australia	India	Argentina	France	China
Canada	Russia	Brazil	Germany	Indonesia
Saudi Arabia	South Africa	Mexico	Italy	Japan
United States	Turkey		United Kingdom	South Korea

26. Issue 4a: for how long the current international monetary system?

27. Issue 4b: for how long the global dominance of the dollar?

• Shortcomings of the present international monetary system

"These are

(1) the large volatility of exchange rates,

(2) the wide and persistent misalignments of exchange rates and huge trade imbalances,

(3) the failure to promote greater coordination of economic policies among the leading economic areas, and

(4) the inability to prevent international financial crises or to adequately deal with them when they do arise."

• Characteristics of the present international monetary system. "The present international monetary system has four main characteristics:

(1) There is a wide variety of exchange rate arrangements (…)

(2) Countries have almost complete freedom of choice of exchange rate regimes. All that is required by the 1978 Jamaica Accords (which formally recognized prevailing exchange rate arrangements) is that nation's exchange rate actions not be disruptive to trade partners and the world economy.

(3) Exchange rate variability has been substantial. This is true for nominal and real, bilateral and effective, short-run and long-run exchange rates. The IMF (2004) estimated that exchange rate variability has been about 5 times larger during the period of flexible (i.e., since l971) than under the preceding fixed exchange rate or Bretton Woods System. Exchange rate variability of 2–3 percent per day and 20–30 percent per year has been common under the present system (…)

(4) Contrary to earlier expectations, official intervention in foreign exchange markets (and therefore the need for international reserves) has not diminished significantly under the present and more flexible exchange rate system as compared with the previous fixed exchange rate system. Nations have intervened in foreign exchange markets not only to smooth out day-to-day movements, but also to resist trends, especially during the l970s and since the mid-l980s."

Salvatore, Dominick (2012): "Exchange rate misalignments and the present international monetary system", Journal of Policy Modeling 34(4), 594-604.

Salvatore, Dominick (2011): "The future tri-polar international monetary system", Journal of Policy Modeling 33(5), 776-785.

• International monetary system: reform causing unstability?

"The monetary system was reshaped in the mid-1940s in the aftermath of the Second World War and again in the early 1970s after the first oil price shock. In both cases, global disruption shook the monetary system and caused prolonged instability. The question now is whether the current system of floating currency blocs with dollar-based trade and reserves can withstand the strains of the global adjustment ahead. It is time to consider alternatives for the IMS and to address the issue of its governance within the context of the postcrisis world economy. The IMS is where tensions from globalization—and the conflict between domestic policy goals and international obligations—tend to coalesce."

• Towards a multi-currency system?

"In the US, domestic priorities for growth and employment may lead to an attitude of 'benign neglect' vis-à-visthe dollar, which generally results in a weaker dollar. The current strength of the US currency, which reflects global risk aversion, with investors attracted to the dollar because of its role as key reserve currency, undermines this stance. Meanwhile, China—now the world's largest exporter as well as the largest holder of dollar assets—faces inflationary pressures as a result of keeping its currency anchored to the dollar, yet fears the instability and losses in reserve values that a loosening of the link would entail. China is also creating tensions by keeping its currency undervalued while preparing for its internationalization (…)At the same time, it has clearly shown the euro area's unwillingness to take the burden—and responsibility—that goes with issuing the world's second reserve currency. In this context, dialogue and policy cooperation play an important role in helping these countries to coordinate their efforts and rebalance the world economy. Policy cooperation should aim to avoid any protectionist reaction to exchange rate movements. It should also help prepare the ground for a smooth transition to a multi-currency system by fostering the exchange of information among the world's main trading areas. That the system—or non-system—was no longer adequate, given the complexity of a burgeoning world economy, has been clear for some time."

"… in today's larger and more integrated world economy the dependence on the dollar as the basis of both trade flows and financial reserves has clearly become excessive, creating a system that is fundamentally unbalanced (…) The existing IMS needs to evolve into a multicurrency system in which a number of international currencies, ideally representing the main trading areas, have the functions of storing value and providing the unit of measure. A multicurrency system would respond more flexibly to the demand for liquidity and would provide a way to diversify the accumulation of reserve assets. Such a system would be better suited to a multipolar world economy."

Subacchi, Paola (2010): "Who is in control of the international monetary system?", International Affairs 86(3), 665-680.

• Power redistribution

"Major developments have dramatically shifted the distribution of power in the system. Many have noted that power is now more widely diffused, both among states and between states and societal actors. Finance is no longer dominated by a few national governments at the apex of the global order. Less frequently remarked is the fact that the diffusion of power has been mainly in the dimension of autonomy, rather than influence (…) While more actors have gained a degree of insulation from outside pressures, few as yet are able to exercise greater authority to shape events or outcomes. Leadership in the system thus has been dispersed rather than relocated—a pattern of change in the geopolitics of finance that might be called *leaderless* diffusion. A pattern of leaderless diffusion generates greater ambiguity in prevailing governance structures. Rule-setting in monetary relations increasingly relies not on negotiations among a few powerful states but rather on the evolution of custom and usage among growing numbers of autonomous agents—regular patterns of behaviour that develop from longstanding practice."

"The diffusion of power, however, has been mainly in the dimension of autonomy, rather than influence—a pattern of leaderless diffusion in financial geopolitics. The days of concentrated power in a largely state-centric system are now over. Three major developments share principal responsibility for this change: (1) the creation of the euro; (2) the widening of global payments imbalances; and (3) the globalization of financial markets."

"The dynamics of power and governance in global finance today are indeed changing. A leaderless diffusion of power is generating greater uncertainty about the underlying rules of the game. At the state level, governments increasingly question the need for a strictly national currency. At the systemic level, governance now relies more on custom and usage, rather than intergovernmental negotiation, to define standards of behaviour."

Cohen, Benjamin J. (2008): "The international monetary system: diffusion and ambiguity", International Affairs 84(3), 455-470.

• International monetary system: status quo prevails

"For quite some time the international monetary system has been incapable of delivering external balances or facilitating smooth adjustments of large imbalances. There is a convergence of interests for the status quo: the United States is keen to preserve the benefits it receives as the key-currency country, while creditor countries continue to accumulate dollar-denominated assets and sterilize increases in the foreign component of the monetary base."

Fratianni, Michele (2012): "The future International Monetary System: Dominant currencies or supranational money? An Introduction", Open Economies Review 23(1), 1-12.

• **The collapse of the international monetary system (1973)**

"The structural causes of the present international monetary crisis remain the same that have been debated interminably, and ineffectually, for more than a decade, i.e. the easy financing of persistent U.S. balance-of-payments deficits by foreign accumulation of U.S. dollars as international reserves, and the consequent suppression of adjustment pressures on the surplus countries as well as on the U.S. This finally exploded in the unprecedented magnitude of such disequilibria and financing over the years 1970-1972."

There was at the time broad intellectual consensus on two basic, commonplace principles: (1) the need for an effective adjustment mechanism, precluding persistent disequilibria in any country's balance of payments; and (2) the need to adjust, and limit, world reserve creation to the non-inflationary requirements of world economic growth."

Triffin, Robert (1973): "The collapse of the international monetary system: Structural causes and remedies", De Economist 121(4), 362-374.

• **Strategies for a future international monetary system**

"At this time, there are (at least) two strategies for the future of the IMS, a conservative strategy and an active one. The former aims at preserving the status quo; the underlying assumption (…) is that the IMS, to work well, must be based on a key currency issued by a dominant country with a deep financial market and a range of short-term instruments accessible by nonresidents (…) The trouble with the conservative strategy is that it has no *coherent* method to arrest the deterioration of the dollar standard or to accelerate the replacement of the dollar by another key currency. The euro has grown as the second most important international currency but the incomplete financial and political integration in Euroland prevents the euro from replacing the dollar as the dominant international currency. The second strategy, the active one, is based on two pillars. The first is that there is an alternative to the hegemonic key-currency situation in the form of a cooperative decision-making process (…). The second is that a progressive reduction of the dual role of the dollar as a national and international currency can be obtained by introducing a supranational money, albeit gradually. The Keynes Plan for the postwar international financial system fits into this category."

Alessandrini, Pietro; Michele Fratianni (2009): "Resurrecting Keynes to stabilize the International Monetary System", Open Economies Review 20(3), 339-358.

• **Dollar as the core of the International Monetary System**

"The US emerged from the two world wars to become the economically and politically dominant core state. The US specialized in the production of the most advanced goods, which involves the use of the most sophisticated technologies and capital-intensive production. The postwar international monetary order, the dual-peg exchange rates or the gold exchange standard, placed the dollar as the single core currency of the international monetary system (…) Nevertheless, after the late 1960s the US no longer held a significant economic advantage over its major allies in the sphere of world production (…) After 1971, the Bretton Woods system was de facto replaced by a regime of freely floating fiat currencies that remains in place to the present day (…) The principal benefits the US enjoyed from the dollar's status as the dominant international currency were: the ability to run balance-of-payment deficits that others could not, the willingness of foreign official institutions to purchaseand hold US government bonds, and the related and crucial discretion of the Federal Reserve to implement expansionary monetary policy to stimulate a recessionary economy or inflate away debts (…) In this sense, the manufacturing disadvantages and the trade deficits of the US in the global economy were offset by the exorbitant privilege of the dollar in the post-Bretton Woods monetary order, which perpetuated the US's position as the core of the world economy (…) The dollar's core status in the international monetary system is the centerpiece of the US's core status in the international system."

• **US-China symbiotic and asymmetric economic relations**

"… the US and China have formed a symbiotic relationship because of the dollar's core status in the international monetary system and China's excessive manufacturing capacity and dependence on foreign markets (…) China in the twenty-first century has been committed to export-oriented growth based on maintaining a low exchange rate (…) The result was the continuous expansion of China's foreign exchange reserves. China used part of these foreign reserves to purchase US Treasury bonds in order to finance American balance-of-payment deficits. On the one hand, China repressed its own domestic consumption and exported large quantities of inexpensive goods, which helped reduce US inflation and stimulate US consumption. On the other hand, China's massive purchase of US Treasury bonds helped lower their yields and bring down US interest rates, as another effort to secure the continuous increase of US demand for China's exports (…) It is estimated that about two-thirds of China's reserves are held in the form of dollar debt (…) The US and China have formed a symbiotic relationship in the capitalist world economy since the 1990s: the US consumes China's cheap exports, paying China in dollars, and China holds US dollars and bonds, in fact lending money to the US."

"China, as a semi-periphery, is more vulnerable in the symbiotic relationship of its own making (…) Were China to dump its dollar reserves and destabilize the world economy, it would definitely hurt itself as well as the US. China would not only lose much the value of its reserves with the falling dollar, but would also jeopardize Americans' ability and willingness to continue to import Chinese goods, which would probably give rise to job loss and social instability in China. On the other hand, China's vulnerability can be seen in the enormous difficulties faced by its manufacturing exports after the global financial crisis (…) Therefore, it is more proper to describe the US–China economic relationship as symbiotic but asymmetric."

• **Old and new Triffin dilemmas**

"Many economists and government officials have concluded that the unipolar, dollar-based monetary system is seriously flawed. Belgian-American economist Robert Triffin pointed out in the 1960s that an international monetary system based on the currency of one country cannot sustainably deliver both liquidity and confidence. More specifically, the continuous growth of the world economy demands a steady stream of dollars, which requires the US to run balance-of-payments deficits. However, excessive US deficits erode people's confidence in the dollar's value (convertible into gold at a fixed price). This inherent conflict between the dollar's role as the world's reserve currency and the declining confidence in the dollar in the postwar international monetary system is called the Triffin dilemma. Though the Triffin dilemma was directed against the Bretton Woods monetary system, it remains valid for today's international monetary system. The modern version posits that the massive amount of dollars created by the US authorities to satisfy world demand is inconsistent with people's confidence in the dollar's value (convertible into a fixed basket of US goods and services). Here arises the question of why the dollar remains the preeminent currency in the international monetary system despite the relative American economic decline and the obvious flaw of dollar hegemony. Eichengreen provides a simple but compelling answer: 'The dollar's dominance was supported by a lack of alternatives.'"

- **Towards a multipolar currency system?**

"Despite the rapid development of RMB [the Chinese currency, the renmimbi] internationalization, it is also worth noting that for the time being the inconvertibility of the RMB, as well as China's capital account control, both impose severe restrictions on the RMB's role as an international reserve currency. Therefore, the internationalization of the RMB is not expected to dethrone the dollar as the key international reserve currency in the foreseeable future (…) The growing roles of the euro and the RMB in the global economy indicate that the unipolar, dollar-based monetary system is evolving into a multipolar currency system that will exercise better discipline over the fiat currencies in the international monetary order."

- **China's global role**

"… the Chinese leadership is thinking beyond the current world system to craft a post-Western world order in an incremental manner. With regard to the three competing hypotheses—the convergence hypothesis, the status quo hypothesis, and the challenge hypothesis—this paper lends no direct support to any of them (…) It is not in China's interest to take extreme measures to destabilize or overthrow the existing world order; thus the radical challenge hypothesis is rejected. Moreover, the US-China economic relationship is asymmetric, which underlies the structural crisis of the world economy. It is argued that BW2 [the revived Bretton Woods system] is not sustainable in the long term; thus, the status quo hypothesis is also rejected. After the global economic crisis, the China leadership demonstrated its concerns with the existing international order, particularly the obvious flaw of a unipolar dollar-based monetary system. In this sense, the convergence hypothesis seems implausible. By anticipating the scenario that China could eventually shift to a more sustainable development model and push the internationalization of the RMB to reform the current international monetary system, one might conclude that China's policy response is more inclined to the challenge hypothesis.

Even so, it is still more proper to describe China as a 'dissatisfied responsible great power.' China's incremental reforms in both domestic and international domains after the global crisis reveal that China as a rising power is no longer a rule-taker, accepting the status quo with regard to the current arrangement of international monetary order. Rather, China is better viewed as some combination of a rule-maker (promoting global reforms of existing arrangements) and a rule-breaker (in that it is creating its own arrangements)."

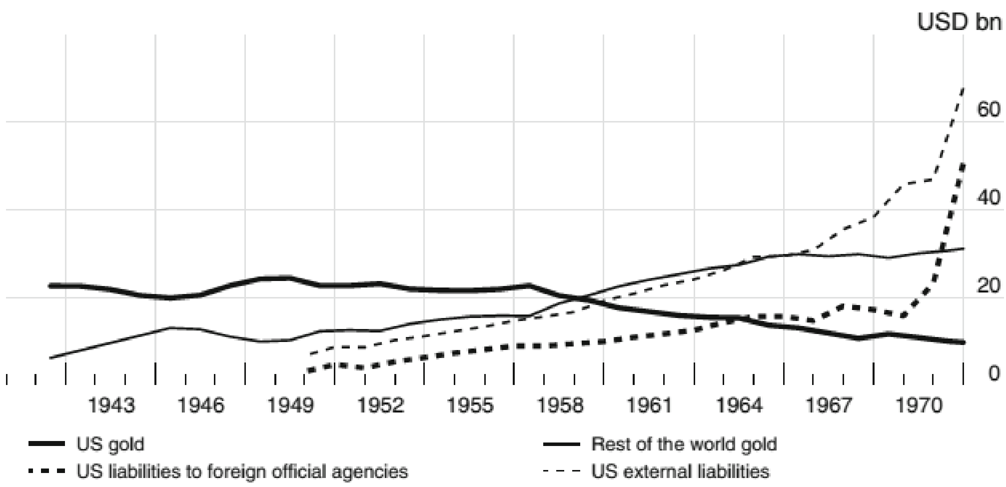
Wang, Zhaohui (2017): "The economic rise of China: Rule-taker, rule-maker, or rule-breaker?", Asian Survey 57(4), 595-617.

28. The Triffin dilemma (Robert Triffin, 1960)

Triffin predicted the end of the Bretton Woods system, which relied on the credibility of the commitment of the convertibility of dollars into gold. Triffin argued that the system faced a dilemma. On the one hand, to meet the international liquidity needs (which were growing with an expansionary world economy), a sufficient amount of dollars should circulate; that is, foreign dollar balances should increase. But, on the other, a large and growing proportion of foreign dollar balances with respect to US gold reserves endangers the credibility of the convertibility commitment. Hence, if the US international liabilities grow too slowly, global trade is restrained and deflation may ensue; but if the US international liabilities grow too much (to satisfy the demands of a growing international trade), the dollar would lose value against gold and a run on the US gold stock will precipitate the downfall of the system. The chart on the right illustrates how the Bretton Woods system broke down.

29. The safe assets dilemma: A new Triffin dilemma?

The Triffin dilemma was the discovery that the unbalanced growth of certain macrofinancial magnitudes could generate systemic instability. The safe assets dilemma would provide another instance of this principle of instability fuelled by unsustainable growth. Specifically, the Triffin dilemma highlights the possibility that the global demand for a stock (US international liabilities) would outgrow the US official holdings of another stock (gold). The safe assets dilemma points out another financial trouble: the possibility that the global demand for another stock (US Treasury liabilities) would outgrow a flow (the US GDP, a flow that provides the taxes needed to service the Treasury's debt).



30. Fundamental problems of the international monetary system I: A Triffin general dilemma

Tommaso Padoa-Schioppa suggested in 2010 a 'Triffin general dilemma': "the stability requirements of the system as a whole are inconsistent with the pursuit of economic and monetary policy forged solely on the basis of domestic rationales in all monetary regimes devoid of some form of supranationality." In particular, as during the Bretton Woods era, the US monetary policy strongly influences global monetary conditions; yet, this policy is conducted without taking into account its international repercussions. In general, the US use its privileged economic status to its own advantage, letting the rest bear the costs of the colateral effects the US decisions cause abroad (the global financial crisis, started in mid-2007 in the US, could be a case at hand; the collapse of the Bretton Woods system, another).

Triffin, Robert (1960): *Gold and the dollar crisis: The future of convertibility*, Yale University Press.

Campanella, Edoardo (2010): "The Triffin dilemma again", Economics: The Open-Access, Open-Assessment E-Journal 4, 2010-25. doi:10.5018/economics-ejournal.ja.2010-25.

Pozsar, Zoltan (2011): "Institutional cash pools and the Triffin dilemma of the U.S. banking system", Working Paper 11/190, IMF (also published in Financial Markets, Institutions & Instruments, 2013).

Maes, Ivo (2013): "On the origins of the Triffin dilemma", European Journal of the History of Economic Thought 20(6), 1122-1150.

Bordo, Michael D.; Robert N. McCauley (2016): "The current account version of the Triffin dilemma", Atlantic Economic Journal, DOI 10.1007/s11293-016-9499-1.

Bordo, Michael D.; Robert N. McCauley (2017): "A global shortage of safe assets: A new Triffin dilemma?", Atlantic Economic Journal, DOI 10.1007/s11293-017-9558-2.

Davis, Ann E. (2018): "The new Triffin dilemma", Review of Radical Political Economy 1-8.

"In the last few years, the relative decline of the economy of the United States and the presumed decline of the dollar as an international currency have led scholars to formulate new versions of the Triffin dilemma. The fear is that in the face of a growing demand for currency reserves, mainly from emerging countries, the supply of reserve instruments in dollars, in particular, treasury bonds, will not be able to increase at the same pace. Two different explanations have been provided for this process. The first, closer to the original version of the Triffin dilemma, maintains that the creation of international liquidity by the United States is due to its large and persistent current account deficits (…). Over time, the persistence of these deficits and the corresponding rise in US debt will result in mistrust in the solvency of the United States and its dollar. In this view, the shortage of international liquidity goes hand in hand with the decline in the dollar's standing as an international currency. In another recent version of the Triffin dilemma, the prospect of a lack of international liquidity is due to the fact that, even if US foreign accounts were in balance, the importance of the US economy within the world economy is decreasing. Correspondingly, the impact of US government deficits (and of the securities issued to cover them) on the world economy is decreasing. It follows that the supply of US Treasuries will result in being inadequate to meet demand (…). The two recent versions of the Triffin dilemma may take different paths, but they both come to the same conclusion, namely, that in the coming decades, the world economy will be marked by a shortage of international liquidity and high levels of deflation."

Seghezza, Elena (2018): "Can swap line arrangements help solve the Triffin dilemma? How?", World Economics, DOI: 10.1111/twec.12669.

31. Fundamental problems of the international monetary system II: Bias against deficit countries

The present international monetary system has a bias against countries with current account deficits. Since countries running a current account surplus have in general no incentive to eliminate the surplus, the burden of the adjustment of international trade imbalances falls exclusively on deficit countries (a point already made by J. M. Keynes). If the deficit countries do not receive the financing need to handle the adjustement or the surplus countries do not pursue more expansionary policies to neutralize the global contractionary effects of the adjustment by deficit countries, the impact of the adjustment on the world economy will be contractionary.

- In connection with this bias, the absence of a cooperative international system to manage exchange rate fluctuations has increased currency speculation and global imbalances.
- Global (or at least multilateral) exchange rate arrangements appear necessary to maintain global stability, to avoid the risk of collapse of the global trading system and to facilitate adjustment in crisis-stricken countries.

32. Fundamental problems of the international monetary system III: Rich-country bias

The present international monetary system is not equitable. Developing countries have a need to accumulate international reserves. These reserves are typically issued by developed (rich) economies. Consequently, developing countries are compelled to transfer resources to developed countries to obtain international reserves. Financial liberalization and the pro-cyclical nature of the capital flows destined to developing countries (foreign capital quickly flies from a developing country with disappointing growth performance) have magnified the inequity bias. In this context, developing countries have been forced to accumulate international reserves in excess as a precaution against sudden or intense contractions in international financing.

- In that respect, it appears that, from the point of view of developing countries, the first role of international financial institutions should be the ability to counteract the pro-cyclical effects of financial markets.
- Not paradoxically, the same financial markets that create trouble in developing countries subject those countries to crisis ratings reinforcing the rich-country bias.

33. The dollar in the international monetary system

The international monetary system is currently characterized by a centre (developed countries) and periphery that uses as reserves assets from the centre. The viability of this system depends on its participants to obtain from it what they want or need. Jeanne (2012) identifies three necessary conditions for the viability:

- the centre must provide liquid and safe assets;
- in a sufficient amount to meet the international demand; and
- providing a satisfactory return (global stable store of value).

The US has been so far playing a central role in the international monetary system. Will it continue to do so and for long? The 2008 financial crisis questioned the safety and liquidity of US assets. It is not clear whether the US economy will be strong enough to meet a rising demand for international liquidity. And the decisions by the US authorities on the return on the dollar (the US interest rate) are solely based on domestic considerations and do not take into account whether the decisions ensure that the dollar remains an international stable store of value. Despite all this, it does not appear likely that, in the near future, the international monetary system will become more multipolar (with the central role of the dollar shared with other currencies, like the euro or the renminbi, or replaced by the IMF's Special Drawing Rights).

Jeanne, Olivier (2012): "The dollar and its discontents", Journal of International Money and Finance 31, 1976-1989

34. Issue 5a: which policies are best for economic development?

35. Issue 5b: does the current international economic organization allow all underdeveloped countries to develop? Why is not the whole world developed?

• The Washington Consensus (John Williamson, 1990)

The Washington Consensus is a set of economic policy recommendations regarding development strategies promoted by the IMF, the World Bank and the US Treasury (all Washington-based institutions). Originally, it was defined by three broad premises: market economy, openness and macroeconomic discipline. The ten original suggested reforms were:

- Fiscal discipline. Reduce large public deficits, which were persumed to lead to balance of payments crises and high inflation.
- Re-ordering public expenditure priorities, towards pro-growth and pro-poor expenditures.
- Tax reform: combine a broad tax base with moderate marginal tax rates.
- Liberalization of interest rates.
- A competitive exchange rate: adoption of an intermediate exchange rate regime (against the two corner doctrine that a country must either fix the exchange rate or let it float freely).
- Trade liberalization.
- Liberalization of inward foreign direct investment.
- Privatization, but paying special attention to how privatization is conducted.
- Deregulation, focusing on easing barriers to market entry and exit.
- Legal security for property rights: ensure access to property rights at acceptable cost.

Serra, Narcís; Joseph E. Stiglitz; eds. (2008): *The Washington Consensus reconsidered: Towards a new global governance*, Oxford University Press, Oxford, UK.

• The Beijing Consensus (Joshua Cooper Ramo, 2004)

The Beijing Consensus (the China model or the Chinese Economic Model) expresses a political economy view opposed to the ('market-friendly') Washington Consensus. The Beijing Consensus describes the features of the economic development model (of political and economic policies) that China is presumed to have followed in the last decades to develop its economy. The Beijing Consensus suggests new rules for a developing country to achieve fast, stable and sustainable economic growth.

- Ramo's original core prescriptions were: (i) a willingness to innovate; (ii) equitable growth and sustainable development; and (iii) a strong belief in a nation's self-determination.
- The China model is often viewed as a resizing of the 'Singapore model' (the long-term one-party developmental state), a developmental model combining state capitalism (specifically, foreign investments with government-linked corporations) with one party-rule (the People's Action Party).

Li, Jun; Liming Wang (2014): *China's economic dynamics: A Beijing Consensus in the making?*, Routledge, London and New York

• The Post-Washington Consensus (Joseph Stiglitz, 1998)

Joseph Stiglitz claimed that 'making markets work" required more than deregulation policies and low inflation: a robust financial system, to whose creation the government contributes greatly, is necessary for markets to deliver efficient outcomes (as was automatically pressumed in the Washington consensus). In Ha-Joon Chang's opinion, the crucial feature of the Post-Washington Consensus is replacing getting-the-prices-right policies with getting-the-institutions-right policies.

36. Development traps

The existence of development traps is denied by the political right: good policies allow any country to escape poverty. The political left considers these traps a by-product of global capitalism. Collier (2007) identifies four such traps: the conflict trap (civil war and coups), the natural resources trap, the trap of being landlocked with bad neighbours, and the trap of bad governance in a small country. No trap is inescapable but globalization has made it more difficult to use the global market to escape from them: to take advantage of globalization, an economy should be sufficiently developed ("strong") and the problem of the economies trapped is that they are insufficiently developed ("weak"). There is then a vicious circle: a country is underdeveloped by some trap because it cannot join properly the globalization process, and it cannot join the process because of the country is underveloped. In 2006, according to Collier (2007), there were 58 trapped countries, with around 980 million people living there. The typical feature of these countries is being small.

Collier, Paul (2007): *The bottom billion: Why the poorest countries are failing and what can be done about it*, Oxford University Press, New York.

Reinert, Erik S. (2011): "Review of The bottom billion by Paul Collier", Journal of Global History 6(1), 156-158.

Easterlin (1981) views the spread of modern economic growth as depending on the diffusion of knowledge of new production techniques, whose acquisition and application of this knowlege has depended on the extent to which the population has acquired the traits and motivations that formal schooling provides. In turn, political conditions and ideological influences seem to have determined in the past the implementation of modern education systems. Easterlin (1988) attributes the insufficient diffusion of technology to the lack of appropriate institutions (social capabilities).

"This, then, is the future to which the epoch of modern economic growth is leading us: a world in which ever-growing abundance is always outpaced by material aspirations, a world of increasing cultural uniformity. (…) The proximate roots of the epoch of modern economic growth lie in the growth of science and diffusion of modern education."

Easterlin, Richard A. (1981): "Why isn't the whole world developed?", Journal of Economic History 41(1), 1-19.

Easterlin, Richard A. (1988): ***Growth triumphant: The twenty-first century in historical perspective*****, The University of Michigan Press, Michigan, IL.**

37. Issue 6: the role of elites, global finance and, in particular, the global financial elite.

• **Global power elites and the transnational capitalist class** (Peter Phillips, 2018)

"[In 1956, C. Wright] Mills described the power elite as those 'who decide whatever is decided' of major consequence. Sixty-two years later, power elites have globalized and built institutions that facilitate the preservation and protection of capital investments everywhere in the world."

"The Global Power Elite function as a nongovernmental network of similarly educated wealthy people with common interests of managing, facilitating, and protecting concentrated global wealth and insuring the continued growth of capital. Global Power Elites influence and use international institutions controlled by governmental authorities—namely, the World Bank, International Monetary Fund (IMF), NATO, World Trade Organization (WTO), G7, G20, and many others. These world governmental institutions receive instructions and recommendations for policy determinations from networks of nongovernmental Global Power Elite organizations and associations."

"We name some 389 individuals in this book as the core of the policy planning nongovernmental networks that manage, facilitate, and protect the continued concentration of global capital. The Global Power Elites are the activist core of the Transnational Capitalist Class—1 percent of the world's wealthy people—who serve the uniting function of providing ideological justifications for their shared interests and establishing the parameters of needed actions for implementation by transnational governmental organizations."

"This concentration of protected wealth leads to a crisis of humanity, whereby poverty, war, starvation, mass alienation, media propaganda, and environmental devastation are reaching a species-level threat. We realize that humankind is in danger of possible extinction and recognize that the Global Power Elites are probably the only ones capable of correcting this condition without major civil unrest, war, and chaos. This book is an effort to bring awareness of the importance of systemic change and redistribution of wealth, to readers as well as to the Global Power Elites themselves, in the hope that they can begin the process of saving humanity."

Phillips, Peter (2018): *Giants: The global power elite*, Seven Stories Press, New York.

Ching, Francis D.K.; Mark M. Jarzombek; Vikramaditya Prakash (2011): *A Global History of Architecture*, 2nd edition, John Wiley, Hoboken, New Jersey.